



ILLINOIS STATE BOARD OF INVESTMENT

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Date: December 29, 2009
To: Governor Pat Quinn and the General Assembly
From: William R. Atwood, Executive Director
Illinois State Board of Investment
Subject: Report on Emerging Money Managers (Public Act 96-0006)

In accordance with Public Act 96-0006 (the "Act"), the Illinois State Board of Investment ("ISBI" or "Board") which directs the investments for the General Assembly Retirement System, the Judges' Retirement System of Illinois, and the State Employees' Retirement System of Illinois, is submitting the following report to the Governor and the Illinois General Assembly.

On December 17, 2009, in furtherance of the new law governing emerging and minority utilization under the Act, the Board adopted the following policies encouraging emerging and minority utilization: the targeted investment policy, the fiduciary diversification policy, the minority contract/service utilization policy, and the minority and Illinois brokers and money managers policy.

A copy of each policy is attached to this report, as well as a brief explanation below:

Targeted Investment Policy (Attachment A-1) - In order to take advantage of emerging organizations, the Board has adopted the targeted investment policy to seek increased participation by emerging investment managers for ISBI's investment program. The Board goes beyond the utilization of emerging managers and has set forth quantifiable goals for the utilization of minority managers. ISBI currently meets or exceeds the emerging and minority investment manager utilization set forth by the Board. The names and addresses of the emerging and/or minority investment managers including the percentage of the assets under management for each emerging/minority investment manager can be found in Attachment A-2.

During fiscal year 2009, ISBI allocated \$861,113,176 to the following emerging and/or minority managers:

- Rhumblin Advisors, an African-American owned investment management firm, with \$16.5 billion in total assets, was allocated an additional total of \$757,825,115 to manage in their Russell 1000 Value, Russell 2000 Value, and S&P 500 Index funds.
- Decatur Capital, an emerging African-American owned investment management firm was allocated an additional \$5 million to manage in their large cap core fund.
- Rock Creek, an emerging woman owned hedge fund of funds was allocated an additional \$98,288,061.

In March 2009, the Board also approved a search for an emerging mid-cap growth domestic equity manager. ISBI Staff and Consultant are currently reviewing the submitted proposals and will make a final selection in the first quarter of 2010.

As of November 2009, approximately \$2.5 billion in ISBI portfolio assets are currently managed by emerging and/or minority owned firms. This number represents 26.8% of ISBI's total assets.

Fiduciary Diversification Policy (Attachment B) – In furtherance of the Act, the Board has adopted this policy and has pledged to use its best efforts to increase the racial, ethnic and gender diversity of its fiduciaries, including consultants and senior investment staff.

Minority Contract/Service Utilization Policy (Attachment C) – In accordance with the Act the Board has set forth policy goals for the utilization of businesses owned by minorities, females, and persons with a disability for all contracts and services.

Minority and Illinois Brokers and Money Managers Policy (Attachment D) – The Board adopted the revised policy which includes minimum expectations for the use of minority owned broker/dealers by the Board's investment advisors.

In accordance with the Board's previously adopted Action Plan, ISBI continues to monitor its external domestic equity managers' and domestic fixed income managers' use of Illinois based and minority brokers/dealers. ISBI raised the brokerage goal to 20% and added international managers to the mandate. Each manager who reports less than 20% utilization is required to submit a written explanation for the shortfall and may be brought before the Board. As of the end of fiscal year 2009, every domestic and fixed income manager exceeded the 20% benchmark.

International brokerage, however, is more complex. ISBI began monitoring international equity manager minority utilization in October of 2008; nonetheless, the majority of ISBI's investment managers have attained their goal. With the procedures aforementioned in place it is expected that, in time, the Board's international managers, like domestic and fixed income managers, will meet and exceed the brokerage goal.

Domestic equity managers executed between 20% to 100% of commissions with minority and female-owned brokerage firms. Fixed Income par value transactions/commissions executed with minority and female-owned brokers during fiscal year 2009 totaled \$1,396,521,125 or 30% of total par value transactions.

Enclosures.

ATTACHMENT A-1

ILLINOIS STATE BOARD OF INVESTMENT **TARGETED INVESTMENT POLICY**

Objective

It is the primary goal of the Illinois State Board of Investment (the "Board" or "ISBI") to develop and maintain an investment program that will help secure the retirement benefits of the participating retirement plans. In order to achieve this, investment managers are selected based on their long-term records of performance, depth of staff and consistency of approach among other characteristics.

However, the Board recognizes that even large, experienced and successful investment organizations were once small, start-up firms with few assets under management. Today many such firms are owned by minorities, women and persons with a disability. These firms are often started by experienced investment professionals, who show great promise, but find it difficult to compete with large majority owned organizations. The firms typically do not meet the minimum standards set for investment managers by large investment programs such as ISBI. Consequently, they are not considered.

In order to take advantage of these emerging organizations, the Board has adopted the following policy to seek increased participation by emerging investment managers¹ for ISBI's investment program.

Furthermore, the Board goes beyond the utilization of emerging managers and has adopted goals for the utilization of minority investment managers².

¹ Effective April 3, 2009, Public Act 96-0006 revised the definition of "emerging investment manager." As a result, the current definition applicable to ISBI is found in 40 ILCS 5/1-109(4) and is defined as "a qualified investment adviser that manages an investment portfolio of at least \$10,000,000 but less than \$10,000,000,000 and is a 'minority owned business', 'female owned business' or 'business owned by a person with a disability' as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act."

² For purposes of this policy, the term "Minority Investment Manager" includes emerging investment managers and/or minority owned businesses, female owned businesses, or businesses owned by a person with a disability as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act.

**Goals for Utilization of Minority-Owned Businesses, Female-Owned Businesses, and
Businesses Owned by Persons with a Disability**

It is the goal of the Board that, subject to its fiduciary responsibility, the use of emerging investment managers shall be significant in each of the broad asset classes in which ISBI is invested and not concentrated in any particular asset class.

The Board has adopted the following minimum goals for the utilization of emerging and minority investment managers³:

**Goals for Utilization of Emerging and Minority Investment Managers
By Investment Manager Classification**

Classification	Percent of Total Portfolio	
	Emerging	Minority
Minority-Owned	5% - 7%	20%
Female-Owned	3% - 5%	3% - 5%
Disabled	0% - 1%	0% - 1%

**Goals for the Utilization of Emerging Investment Managers
By Asset Class**

Asset Class	Percent of Asset Class	
	Emerging	Minority
Equities	8% - 10%	30%
Fixed Income	10% - 12%	10% - 12%
Alternatives*	1% - 5%	1% - 5%

* Alternative investments are not subject to the requirements set forth in Public Act 96-0006.

These goals will be reviewed annually.

Documentation of a current state certification must be provided to the Board before any asset allocation is received. Emerging managers may represent any asset class within ISBI's asset allocation. ISBI staff and investment consultants shall seek out emerging firms and present the most qualified firms to the trustees for consideration.

Adoption October 24, 2003
Amended June 22, 2005
Amended December 18, 2009

³ Public Act 96-0006 requires the establishment of "3 separate goals for (i) emerging investment managers that are minority owned businesses; (ii) emerging investment managers that are female owned businesses; and (iii) emerging investment managers that are businesses owned by a person with a disability."

ATTACHMENT A-2

Emerging and Minority List

November 30, 2009

Asset Class	Investment Manager	Addresses	Emerging	Minority*	Women	Disabled	Illinois	Market Values	% of Total Fund
Fixed Income- Intermediate	LM Capital (M)	401 B Street, Suite 950 San Diego, CA 92101	Yes	L	No	No	No	\$304,597,778	3.2%
Intermediate Fixed Income								\$304,597,778	3.2%
Large-Cap Value Equity	Atlanta Life (E)	100 Auburn Avenue, NE Atlanta, GA 30303	Yes	AA	No	No	No	\$60,345,583	0.6%
Large-Cap Value Equity	Rhumbline R1000 V (M)	30 Rowes Wharf, Suite 350 Boston, MA	No	AA	No	No	No	\$439,864,772	4.6%
Large-Cap Value Equity								\$500,210,355	5.3%
Large-Cap Core Equity	Rhumbline S&P 500 Fund (M)	30 Rowes Wharf, Suite 350 Boston, MA	No	AA	No	No	No	\$635,386,058	6.7%
Large-Cap Core Equity	Decatur Capital (E)	250 E. Ponce De Leon Ave., Ste 325 Decatur, GA 30030	Yes	AA	No	No	No	\$9,277,691	0.1%
Large-Cap Core Equity								\$644,663,749	6.8%
Large-Cap Growth Equity	BDHS (E)	211 N Broadway, Ste 2080 St. Louis, MO 63102	Yes	AA	No	No	No	\$20,615,955	0.2%
Large-Cap Growth Equity	Lynnmar (E)	401 Route 73 North, Building 10, Suite 320, Marlton, NJ 08053	Yes	AA	Yes	No	No	\$113,960,696	1.2%
Large-Cap Growth Equity	Profit (E)	8720 Georgia Avenue, Suite 808, Silver Spring, MD 20910	Yes	AA	No	No	No	\$130,091,883	1.4%
Large-Cap Growth Equity	Rhumbline R1000 G (M)	30 Rowes Wharf, Suite 350 Boston, MA	No	AA	No	No	No	\$222,962,615	2.4%
Large-Cap Growth Equity								\$487,631,149	5.1%
Small-Cap Value Equity	Channing Capital (E)	10 S LaSalle St., Ste 2650, Chicago, IL 60601	Yes	AA	No	No	Yes	\$29,558,348	0.3%
Small-Cap Value Equity	Fiduciary Mgmt (E)	55 W. Monroe St., Ste 2550, Chicago, IL 60603	Yes	No	Yes	No	Yes	\$43,492,098	0.5%
Small-Cap Value Equity	Opus Capital (E)	One West Fourth Street, Suite 415, Cincinnati, OH 45202	Yes	AA	Yes	No	No	\$67,510,834	0.7%
Small-Cap Value Equity	Rhumbline R2000 V (M)	30 Rowes Wharf, Suite 350 Boston, MA	No	AA	No	No	No	\$112,364,995	1.2%
Small-Cap Equity								\$252,926,275	2.7%
Hedge Fund of Funds	Rock Creek (E)	1133 Connecticut Ave., NW Washington, DC 20036	Yes	No	Yes	No	No	\$236,569,925	2.5%
Hedge Fund of Funds								\$236,569,925	2.5%
International Equity	GlobeFlex (E)	4365 Executive Drive, Ste 720 San Diego, CA 92121	Yes	No	Yes	No	No	\$73,825,427	0.8%
International Equity								\$73,825,427	0.8%
Private Equity	Castle Ventures II, L.P.	930 Winter Street, Suite 200 Waltham, MA 02451	Yes	No	Yes	No	No	\$5,662,035	0.1%
Private Equity	Inroads Capital Partners L.P.	1603 Orrington Avenue, Suite 2050 Evanston, IL 60201	Yes	No	Yes	No	Yes	\$415,843	0.0%
Private Equity	Reliant Equity Partners II	645 N. Michigan Ave., Ste 809 Chicago, IL 60611	Yes	AA	No	No	Yes	\$520,351	0.0%
Private Equity	Valor Fund II	200 S. Michigan Ave., Ste. 1020 Chicago, IL 60601	Yes	L	No	No	Yes	\$9,113,838	0.1%
Private Equity								\$15,712,067	0.2%
Real Estate	MacFarlane Urban Real Estate Fund II, L.P.	201 Spear Street, 14th Floor San Francisco, CA 94105	Yes	AA	No	No	No	\$4,279,517	0.0%
Real Estate	RIJ Lodging II	3 Bethesda Metro Center, Ste 1000, Bethesda, MD 20814	Yes	AA	No	No	No	\$22,413,466	0.2%
Real Estate								\$26,692,983	0.3%
Total Emerging and Minority Managers								\$2,542,829,708	26.8%
Total Emerging Managers								\$1,132,251,268	11.9%
Total Portfolio								\$9,484,041,609	100.0%

*NOTE: AA (African American), L (Latino)

ATTACHMENT B

ILLINOIS STATE BOARD OF INVESTMENT **FIDUCIARY DIVERSIFICATION POLICY**

The Illinois State Board of Investment (the "Board") acts as fiduciary for the General Assembly's Retirement System, Judges' Retirement System and State Employees' Retirement System of Illinois. As a fiduciary, the Board is responsible for managing, investing, reinvesting, preserving and protecting fund assets.¹

It is the policy objective of the Board to comply with all federal and state statutes, rules and regulations pertaining to the Board's investments. Public Act 96-0006 (the "Act") encourages the Board to increase the racial, ethnic, and gender diversity of its fiduciaries, to the greatest extent feasible within the bounds of financial and fiduciary prudence.²

In furtherance of the Act, it is the goal of the Board to use its best efforts to increase the racial, ethnic, and gender diversity of its fiduciaries, including its consultants and senior staff.

The Board currently has a total of ten employees, with one office located in Chicago, Illinois. Because of the highly specialized field of investments and the nature of the positions, seven employees and the Executive Director are exempt by statute from the State of Illinois Personnel Code and are hired by the Board. The three remaining positions are under the State of Illinois Personnel Code and vacancies are filled through the Department of Central Management Services.

Due to the small size of the staff and the number of individuals in these categories during the past fiscal year, there is no underutilization. As vacancies occur, the Board will make every effort to increase the racial, ethnic, and gender diversity of its consultants and senior staff in accordance with this Policy.

In accordance with its Affirmative Action Plan, the Board submits quarterly Workforce Analysis and Workforce Transaction Reports to the Department of Human Rights. Attached are copies of the Fiscal Year 2010 Affirmative Action Plan and the most recent reports filed, which contain the current racial, ethnic, and gender classifications of the Board's senior staff. The Board will continue to report to the Department of Human rights on a quarterly basis.

This goal will be monitored and reviewed annually in conjunction with the annual Affirmative Action Plan.

Adopted: December 18, 2009

¹ See 40 Ill. Comp. Stat. § 5/22A-101 *et seq.* (2004).

² See 40 Ill. Comp. Stat. § 5/1-109.1(4).

ATTACHMENT C

ILLINOIS STATE BOARD OF INVESTMENT **MINORITY CONTRACT/SERVICE UTILIZATION POLICY**

The Illinois State Board of Investment (the "Board") is committed to providing opportunities for increasing utilization of businesses owned by minorities, females, and persons with disabilities.

Public Act 96-0006 (the "Act") states that the Board shall adopt a policy which sets forth goals for the utilization of businesses owned by minorities, females, and persons with disabilities for all contracts and services. According to the Act, "The goals shall be based on the percentage of total dollar amount of all contracts let to minority owned businesses, female owned businesses, and businesses owned by a person with a disability, as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act."¹

In furtherance of the Act, the Board, subject to its fiduciary responsibility, has set forth a minimum goal of 0-1% of the total dollar amount for all contracts for the utilization of businesses owned by minorities, females, and persons with disabilities. Examples of such contracts and services include, but are not limited to, legal, software, research and information technology services.

Attached is the Board's most current list of vendors servicing the Defined Benefit Plan.

These goals will be reviewed annually.

Adopted: December 18, 2009

¹ See 40 ILCS 5/1-101.2(6).

ATTACHMENT D

ILLINOIS STATE BOARD OF INVESTMENT **MINORITY AND ILLINOIS BROKERS AND MONEY MANAGERS POLICY**

Objective

It is the policy objective of the Illinois State Board of Investment ("ISBI" or the "Board") to increase access and business with state certified, minority-owned brokers and investment advisors. As a part of this policy, the Board has adopted minimum expectations for the use of minority-owned broker/dealers¹ by the Board's investment advisors. The minimum expectations are established based on the asset class in which the investment advisor invests. On an annual basis, the Board will assess the effectiveness of the procedures established by which these goals are to be met, unless circumstances warrant more frequent review. Further, it is the policy objective of the Board to encourage managers to direct 25% of their trades to Illinois-based broker/dealers. It is further the policy objective of the Board to encourage managers to seek to obtain best price execution at the Chicago Stock Exchange, which can be achieved by utilizing the Institutional Brokers of the Chicago Stock Exchange.

Allocations of the Board's assets to state certified minority managers will be made in accordance with the fiduciary standards under which the investment advisors operate. Broker/dealer transactions completed with state certified, minority firms on behalf of the Board must be completed at rates fully competitive with the market.

Subject to best execution, investment managers for the Board's separately managed investment portfolios are strongly encouraged to direct the below percentages of total eligible commission dollars or eligible trading volume to minority-owned broker/dealers.

<u>Asset Class</u>	<u>Minimum Goal as a Percentage</u>
U.S. Equity	20%
International Equity	20%
Fixed Income	20%

Brokerage

1. Staff will strongly encourage verbally and in writing the Board's domestic and international equity and investment grade fixed income managers to directly utilize

¹ In accordance with Public Act 96-0006, "minority-owned broker dealer" means "a qualified broker-dealer who meets the definition of 'minority owned business', 'female owned business', or 'business owned by a person with a disability', as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act."

state certified minority brokers. Staff will add additional asset classes when appropriate.

2. Staff will strongly encourage verbally and in writing for investment managers to direct 25% of their trades to Illinois-based broker/dealers. For purposes of this policy, an Illinois-based broker/dealer is any dually licensed broker/dealer incorporated and domiciled in the State of Illinois.
3. Staff will strongly encourage verbally and in writing managers to obtain best price execution at the Chicago Stock Exchange ("CHX"), which may be achieved by utilizing the list of Institutional Brokers of the CHX. For purposes of this policy, the list of Institutional Brokers of the CHX is comprised of Cheevers & Co., Inc., Chancellor Dougall, E*Trade Securities, Lek Securities, and Nutmeg Securities, Ltd.
4. Staff will provide verbally and in writing to state certified minority brokers contacts for the Board's domestic and international equity and investment grade fixed income managers.
5. Staff will monitor the use of Illinois brokers and state certified minority brokers by the Board's managers, and report results to the Board on a quarterly basis. If a manager reports less than their encouraged percentage of state certified minority broker utilization staff will require the manager to report in writing the reason for the shortfall, at which time the Board will decide if the manager's practices are in accordance with the policy.
6. Staff will consider the use of Illinois brokers and state certified minority brokers when evaluating existing managers.
7. No step outs will be allowed. International brokerage policy applies to Ex-emerging markets with best efforts for emerging markets.

Asset Management

8. Staff will review the statistical requirements for manager searches as needed to provide better access to state certified, minority managers that have appropriate products.
9. Staff will seek to include at least one state certified, minority candidate in final Staff interviews. Staff will inform the Board of all minority candidates.
10. Staff will regularly meet with Illinois minority managers on-site, and learn more about the Illinois minority manager community.
11. ISBI will make best efforts to include a meaningful representation of state certified minority money managers in the state Deferred Compensation Plan.

12. Staff will encourage consultants to be proactive and use creative approaches in achieving the Board's objectives with respect to the use of minority firms.

Consequences of Non-Compliance

The Board continuously monitors investment managers' compliance with this policy and has established a series of consequences for those investment managers who continually fail to meet expectations. The investment managers are expected to achieve the desired levels over rolling twelve-month periods. The following steps will occur if the investment manager continues to fall short of expectations:

1. A follow-up letter will be distributed to the investment managers not achieving the minimum level of minority-owned broker/dealer usage. The investment managers will be reminded of the usage expected by the Board.
2. Not achieving the desired level of minority-owned broker broker/dealer usage will be noted in the annual investment manager review presented to the Board.
3. Staff will conduct a meeting with the investment manager to discuss the reasons for not achieving the desired level of brokerage.
4. Investment managers not achieving the expected levels of minority-owned broker/dealer usage may be subject to a moratorium on additional funding.
5. If an investment manager fails to comply with the request, they may be invited to appear before the Board to explain why they are unable to achieve the desired level of trading.
6. The investment manager may be placed on the Investment Managers Watch List.

Adopted: September 21, 2001

Amended: October 24, 2003

Amended: June 22, 2005

Amended: March 20, 2009

Amended: December 18, 2009

FY 10
Report on Emerging Investment Managers
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